

## Internal Revenue Service

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Department of the Treasury  
Washington, DC 20224

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B04 – PLR-101171-10

Date: June 25, 2010

Re:

### Legend:

Settlor

Daughter

Spouse

Grandchild

1

Grandchild

2

Grandchild

3

Grandchild

4

Grandchild

5

Bank

Trust

Court

Date 1

Date 2

Date 3

Date 4

Date 5

Date 6

State

Dear \_\_\_\_\_ :

This responds to a letter dated December 30, 2009, and other correspondence, requesting rulings on behalf of Trust regarding the income, estate, and generation-skipping transfer (GST) tax consequences of a proposed division and modifications of Trust.

### Facts

The facts submitted and representations made are as follows. On Date 1, which is prior to September 25, 1985, Settlor executed an irrevocable trust (Trust) to benefit Daughter, her spouse (Spouse), and their children (Grandchildren). Daughter and a bank were named as co-trustees. Settlor died on Date 2. Spouse died on Date 3. Daughter died on Date 4.

Under Item II of Trust, after the deaths of Daughter and Spouse, all of the net income is to be paid in equal amounts to Settlor's grandchildren, during their respective lifetimes. Upon the death of any of Settlor's grandchildren descended from Daughter, his or her share of net income will be paid *per stirpes* to the deceased grandchild's child or children (Great grandchildren).

Item II further provides that Trust will terminate twenty-one years following the death of the last living child of Daughter who was alive when Trust was executed and who survives Daughter. Upon termination, the trustees will divide the property of Trust among those beneficiaries then living on a *per stirpes* basis and not *per capita*.

Item XIII provides:

If, at any time, any one of the beneficiaries of the trust while he or she is entitled to the net income or a portion thereof should be in need of funds in excess of the net income derived from their respective shares of the trust estate in order to provide for his or their reasonable care, maintenance, or proper education, or on account of any illnesses, infirmity, or other like emergency affecting either of them, then the trustees are authorized in their sole discretion to make advances by anticipating the future income of such beneficiary, for said purpose, and in such amounts as the said trustees shall deem necessary and proper.

Item XVII provides that Daughter's children living on the date of execution were Grandchild 1, Grandchild 2, Grandchild 3, and Grandchild 4. Item XVII further provides that any grandchild or any great grandchild born after the execution of Trust and after

Daughter's death will be beneficiaries of Trust. Daughter's child, Grandchild 5, was born after the execution of Trust.

The current income beneficiaries of Trust are Grandchild 1 through 5 (Grandchildren 1-5). There are also Great grandchildren living who are the current potential contingent remainder beneficiaries of Trust, and they are all adults.

Pursuant to Item IX of Trust, in her will, Daughter provided for the appointment of her successor individual trustees from among her children and their children. Currently, Grandchild 2 and Grandchild 5 are serving as the individual co-trustees, and Bank is serving as the corporate trustee.

On Date 5, the individual co-trustees of Trust petitioned State Court to modify Trust (Petition). Petition was amended on Date 6. The individual co-trustees represent that they will file a second amendment to Petition. In Petition and its amendments, the individual co-trustees seek a Court order to (i) approve the division of Trust into five equal and separate trusts, one for the benefit of each of Grandchildren 1-5, and (ii) approve certain modifications to Trust. A pro rata portion of the assets of Trust will be allocated to each of the five separate trusts.

The proposed modifications are as follows. Item II will be modified to provide that (i) the net income of each grandchild's trust will be paid to that grandchild for life; and (ii) upon a grandchild's death, the net income of the deceased grandchild's trust will be paid to his or her child or children (Great grandchildren), *per stirpes*, for their respective lifetimes or until the trusts terminate as provided under Item II. The trust of a grandchild who dies without a surviving child or children will be added on a *per stirpes* basis to the then existing trusts for Settlor's other grandchildren and their children, to be held and distributed as if originally part of such trusts.

Item XIII will be modified as follows:

If, at any time, any one of the beneficiaries of the trust while he or she is entitled to the net income or a portion thereof should be in need of funds in excess of the net income derived from their respective trust or share of such trust in order to provide for his or her education, including college and professional education, and medical, dental, hospital and nursing expenses and expenses of invalidism then the Trustee(s) are authorized in their sole discretion to encroach on the principal of such separate trust of such beneficiary, in such amounts as the Trustee(s) of such Trust shall deem necessary in its judgment to provide for the support of such beneficiary, taking into consideration any other available resources such beneficiary may have to the knowledge of the Trustee.

Bank will resign as co-trustee. Item IX will be modified as follows. Each grandchild's trust will have no more than three co-trustees, composed of one income beneficiary, one remainder beneficiary, and one Independent Trustee chosen by a majority of the current income beneficiaries of each respective trust. Upon the death of any grandchild, each trust will have no more than three co-trustees, composed of two income beneficiaries and one Independent Trustee. In the event there exist more than two Great grandchildren, each great grandchild willing to serve will serve as a co-trustee on a two year rotation. If a successor trustee is not appointed, a remaining co-trustee may serve as sole trustee. As amended, Item IX will define "Independent Trustee" as a person or entity, regardless of the form of the entity, that is not a related or subordinate trustee, as defined in § 672(c) of the Internal Revenue Code.

The remaining provisions of Trust will remain the same and apply to each grandchild's trust. Specifically, Item II regarding the termination of Trust will not be modified and will apply to the five separate trusts. The division and modifications will be effective upon the receipt of a favorable ruling from the Internal Revenue Service and an order from Court.

Grandchildren 1-5 and Great grandchildren have all consented to Petition and its amendment and represent that they will consent to the second amendment to Petition. A State Court appointed guardian ad litem for the unknown contingent income or remainder beneficiaries has consented to Petition and its amendment and it is represented that he will consent to the second amendment to Petition.

It is represented that no actual or constructive additions have been made to Trust since Date 1.

Trust has requested the following rulings:

1. The proposed division and modifications of Trust and resignation of Bank will not cause any distribution from, or termination of any interest in, Trust or the resulting separate trusts to lose their status as exempt from the generation-skipping transfer tax by reason of § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations.

2. The proposed division of Trust will not result in the realization of gain or loss under §§ 61 and 1001.

3. The proposed modifications of Item XIII and Item IX and the resignation of Bank will not cause the individual trustees to be treated as having general powers of appointment for purposes of § 2041.

#### Law and Analysis

Ruling 1:

Section 2601 of the Internal Revenue Code imposes a tax on each generation-skipping transfer which is defined under § 2611 as a taxable distribution, taxable termination, or a direct skip.

Under § 1433(a) of the Tax Reform Act of 1986 (Act), the generation-skipping tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i), the tax does not apply to a transfer from a trust, if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date. Under § 26.2601-1(b)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor had a power that would have caused inclusion of the trust in his or her gross estate under §§ 2038 or 2042, if the settlor had died on September 25, 1985.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph are generally applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. Unless noted otherwise, the rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(D) provides that a modification of the governing instrument of an exempt trust by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the tax if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. A modification of an exempt trust will result in a shift in beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a generation-skipping transfer or the creation of a new generation-skipping transfer. A modification that is administrative in nature that only indirectly increases the amount transferred will not be considered to shift a beneficial interest in the trust.

Section 26.2601-1(b)(4)(i)(E), Example 5, illustrates a situation where a trust that is otherwise exempt from the generation-skipping transfer tax is divided into two trusts.

Under the facts presented, the division of a trust into two trusts does not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the division, and the division does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Accordingly, the two partitioned trusts will not be subject to the generation-skipping transfer tax.

Section 26.2601-1(b)(4)(i)(E), Example 10, considers the following situation. In 1980, Grantor established an irrevocable trust for the benefit of Grantor's issue, naming a bank and five other individuals as trustees. In 2002, the appropriate local court approves a modification of the trust that decreases the number of trustees which results in lower administrative costs. The modification pertains to the administration of the trust and does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification. In addition, the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Therefore, the trust will not be subject to the provisions of chapter 13.

In this case, Trust is exempt from the generation-skipping transfer tax because it was irrevocable on or before September 25, 1985, and it is represented that no actual or constructive additions have been made to Trust since that date.

Both before and after the proposed modifications, under Item II, all of the net income will be paid to Settlor's grandchildren or, *per stirpes*, to the children of a deceased grandchild. Under the proposed modifications, the trust of a grandchild who dies without a surviving child or children will be added on a *per stirpes* basis to the then existing trusts for Settlor's other grandchildren and their children. Prior to the modifications, pursuant to Item XIII, the co-trustees have the power to distribute advances of future income to the current income beneficiaries of Trust for specified purposes. Under the proposed modification of Item XIII, the co-trustees will have the power to distribute principal from each grandchild's trust to a current income beneficiary for specified purposes. Under the proposed modifications, the separate trusts will terminate under the original termination provision of Trust, and each separate trust will be distributed, *per stirpes*, to the then living beneficiary or beneficiaries.

Thus, the division of Trust and proposed modifications of Trust will not result in a shift of any beneficial interest in Trust or in the resulting separate trusts to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons holding the beneficial interests prior to the division and modifications, and will not extend the time for vesting of any beneficial interest beyond the period provided for under Trust. Further, the modification of the trustee provisions and the resignation of Bank as trustee are administrative in nature and will not be considered to shift a

beneficial interest in the trust. Accordingly, based on the facts submitted and representations made and, assuming Court issues an order approving the proposed division and modifications, we rule that the proposed division and modifications of Trust and resignation of Bank will not cause any distribution from, or termination of any interest in, Trust or the resulting separate trusts to lose their status as exempt from the generation-skipping transfer tax by reason of § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i).

Ruling 2:

Section 61(a)(3) provides that gross income includes gain derived from dealings in property.

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized over the adjusted basis provided in § 1011 for determining gain, and the loss is the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized. Under § 1001(c), the entire amount of gain or loss must be recognized, except as otherwise provided.

Section 1.1001-1(a) of the Income Tax Regulations provides that, except as otherwise provided in subtitle A, the gain or loss realized from the exchange of property for cash or for other property differing materially either in kind or in extent is treated as income or loss sustained.

Rev. Rul. 56-437, 1956-2 C.B. 507, holds that the conversion of a joint tenancy in stock to a tenancy in common in order to eliminate the survivorship feature and the partition of a joint tenancy in stock are not sales or exchanges. Similarly, divisions of trusts are also not sales or exchanges of trust interests where each asset is divided pro rata among the new trusts. See Rev. Rul. 69-486, 1969-2 C.B. 159 (pro rata distribution of trust assets is not a sale or exchange).

In this case, the assets of Trust will be distributed in kind on a pro rata basis among the five separate trusts. Accordingly, based on the facts submitted and representations made, we rule that the division of Trust will not result in the realization of gain or loss under §§ 61 and 1001.

Ruling 3:

Section 2514(b) provides that the exercise or release of a general power of appointment created after October 21, 1942, shall be deemed a transfer of property by the individual possessing such power.

Section 2514(c) defines the term “general power of appointment” as a power which is exercisable in favor of the individual possessing the power, his estate, his

creditors, or the creditors of his estate. However, a power to consume, invade, or appropriate property for the benefit of the possessor which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the possessor shall not be deemed a general power of appointment.

Section 2041(a)(2) provides that the value of a decedent's gross estate shall be determined by including the value at the time of death of all property to the extent of any property with respect to which the decedent has at the time of death a general power of appointment created after October 21, 1942, or with respect to which decedent has at any time exercised or released such a power of appointment by a disposition that is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive.

Section 2041(b)(1) defines the term "general power of appointment" as a power which is exercisable in favor of the decedent, the decedent's estate, the decedent's creditors, or the creditors of the decedent's estate. However, § 2041(b)(1)(a) provides that a power to consume, invade, or appropriate property for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent shall not be deemed a general power of appointment.

Section 20.2041-1(b)(1) of the Estate Tax Regulations provides that the term "power of appointment" includes all powers that are in substance and effect powers of appointment regardless of the nomenclature used in creating the power and regardless of local property law connotations. The mere power of management, investment, custody of assets, or the power to allocate receipts and disbursements as between income and principal, exercisable in a fiduciary capacity, whereby the holder has no power to enlarge or shift any of the beneficial interests therein except as an incidental consequence of the discharge of such fiduciary duties is not a power of appointment.

Under § 20.2041-1(c)(2), a power is limited by an ascertainable standard if the extent of the holder's duty to exercise and not exercise the power is reasonably measurable in terms of his needs for health, education, or support (or any combination of them). The words "support" and "maintenance" are synonymous and their meaning is not limited to the bare necessities of life. A power to use property for the comfort, welfare, or happiness of the holder of the power is not limited by the requisite standard. Examples of powers which are limited by the requisite standard are powers exercisable for the holder's "support," "support in reasonable comfort," "maintenance in health and reasonable comfort," "support in his accustomed manner of living," "education, including college and professional education," "health," and "medical, dental, hospital and nursing expenses and expenses of invalidism." In determining whether a power is limited by an ascertainable standard, it is immaterial whether the beneficiary is required to exhaust his other income before the power can be exercised.



While legal rights and interests in property (such as the creation and the breadth of a power to appropriate or consume the principal of a trust) is a matter of state law, it is federal law that designates what rights or interests so created shall be taxed. See Morgan v. Commissioner, 309 U.S. 78, 80 (1940). Thus, whether a trustee's power to consume, invade, or appropriate the principal of Trust for his or her own benefit is limited by an ascertainable standard relating to health, education, support, or maintenance is a matter of State law.

In the present case, prior to the modification, pursuant to Item XIII, Bank, Grandchild 2, and Grandchild 5 have the power as trustees to distribute principal (i.e., advances of future income) to a class of beneficiaries that includes Grandchild 2 and Grandchild 5. This power is exercisable to provide for a beneficiary's "reasonable care, maintenance, or education, or on account of any illness, infirmity, or other like emergency." The first part of this standard to provide for a beneficiary's "reasonable care, maintenance, or education, or on account of any illness, infirmity" is an ascertainable standard relating to health, education, support or maintenance within the meaning of the Estate Tax Regulations.

With respect to the last part of the standard "or other like emergency," a review of State law reveals no statutory or case law authority directly on point as to whether a trustee's power to invade principal for "other like emergenc[ies]" is an ascertainable standard relating to health, education, support or maintenance. Thus, under Commissioner v. Bosch, 387 U.S. 456 (1967), we must forecast what the law of State is likely to be. Under Bosch, state law as announced by the highest court of the state is to be followed, but if there is no decision by the highest court, we must apply what we find to be the state law after giving "proper regard" to relevant rulings of other courts. Id. at 465. A review of relevant rulings of other courts revealed only a few cases addressing this issue under § 2041 and these cases are factually distinguishable from this case. See Sowell v. Commissioner, 708 F.2d 1564 (10<sup>th</sup> Cir. 1983), *action on dec.*, 1984-042 (May 10, 1984), and Hunter v. United States, 597 F. Supp. 1293 (W.D. Pa. 1984). However, in a few cases, courts have addressed whether a trustee's power to distribute principal for "other emergencies" was limited by an objective standard for purposes of §§ 2036 and 2038 and these cases provide some guidance for purposes of this ruling request.

For example, in Budd v. Commissioner, 49 T.C. 468, 469 (1968), *acq.* 1973-2 C.B. 1, the trustees had the authority to distribute principal from the trust in the event of "sickness, accident, misfortune or other emergency." The Tax Court concluded that the trustees' powers were limited by an external standard fixed by the trust instrument and, accordingly, held that these powers did not result in inclusion in the decedent's estate under §§ 2036 and 2038. Id. at 475. In Budd, use of the word "other" before the word "emergency" limited the meaning of the "emergency" to the type of emergencies itemized before the word "other." In that case, the Tax Court considered the state law of

Minnesota, Illinois, and California. In Estate of Pardee v. Commissioner, 49 T.C. 140, 144 (1967), the trustee had the authority to distribute principal from the trust for the beneficiaries' "education, maintenance, medical expenses, or other needs occasioned by emergency." The Tax Court concluded that the use of "other needs" following the words "education, maintenance" and "medical expenses" showed that the kind of needs referred to were similar to those specifically described. In that case, the Tax Court held that the exercise of these powers by the grantor-trustee was controlled by objective standards and, therefore, the trust was not includible in the grantor's gross estate under § 2038.

As in Budd and Estate of Pardee, the use of the words "other like" before "emergency" limits the meaning of the word "emergency" to the type of emergency itemized before the word "other." Therefore, after giving proper regard to these relevant rulings, we conclude that the highest court in State would conclude that a trustee's power to distribute principal for the beneficiary's "reasonable care, maintenance, or proper education, or on account of any illnesses, infirmity, or other like emergency" is limited by an ascertainable standard relating to health, education, support or maintenance. See § 20.2041-1(c)(2); Budd, 49 T.C. at 475; Estate of Pardee, 49 T.C. at 144. Therefore, Grandchild 2 and Grandchild 5 will not be treated as having released any general powers of appointment for purposes of § 2514 as a result of the trust modifications.

After the resignation of Bank and the proposed modifications of Item XIII and Item IX, the co-trustees will have the power to distribute principal from each grandchild's trust to a current income beneficiary, which may include one of the co-trustees for the beneficiary's "education, including college and professional education, and medical, dental, hospital and nursing expenses and expenses for invalidism." This power is limited by an ascertainable standard relating to health, education, support or maintenance. See § 20.2041-1(c)(2). Accordingly, based on the facts submitted and representations made and, assuming Court issues an order approving the proposed division and modifications, we rule that the proposed modifications of Item XIII and Item IX and the resignation of Bank will not cause the individual trustees to be treated as having general powers of appointment for purposes of § 2041.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the proposed modifications of Trust under the cited provisions or under any other provisions of the Code. The estate and generation-skipping transfer tax rulings in this letter apply only to the extent that the relevant sections of the Internal Revenue Code are in effect during the period at issue.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

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Lorraine E. Gardner  
Senior Counsel, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure

Copy for section 6110 purposes